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 National Union Fire Insurance Company of Pittsburgh,  
 Pennsylvania and American Home Assurance Company, and  
 Third Party Defendant American International Group, Inc.

UNITED STATES DISTRICT COURT  
 NORTHERN DISTRICT OF CALIFORNIA

NATIONAL UNION FIRE INSURANCE  
 COMPANY OF PITTSBURGH,  
 PENNSYLVANIA, a corporation, and  
 AMERICAN HOME ASSURANCE COMPANY, a  
 corporation,

Plaintiffs,

v.

ELECTRIC TRANSIT INCORPORATED, an Ohio  
 corporation and joint venture of SKODA, a.s., and  
 AAI corporation, a Maryland corporation, SKODA,  
 a.s., SKODA OSTROV, s.r.o., a corporation, AAI  
 CORPORATION, a corporation, and CZECH  
 EXPORT BANK, a corporation,

Defendants.

AND RELATED CLAIMS

Case No. C-04-03435 JSW (MEJ)

**SURETIES' NOTICE OF MOTION  
 AND MOTION TO ALLOW  
AMENDMENT OF EXPERT'S  
 REPORT**

[Filed Concurrently with Declarations of  
 D. Veis and E. Muramoto; Proposed Order;  
 Motion for Order Shortening Time for  
 Hearing]

Date: August 10, 2007  
 Time: 9:00 a.m.  
 Courtroom: 2

**Assigned to Hon. Jeffrey S. White**

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1 TO THE COURT, ALL PARTIES AND TO THEIR ATTORNEYS OF RECORD:

2 PLEASE TAKE NOTICE that on August 10, 2007 at 9:00 a.m. or as soon as this matter  
3 may be heard, Plaintiffs and Counterclaim Defendants, National Union Fire Insurance Company  
4 of Pittsburgh, PA., American Home Assurance Company, and Third-Party Defendant, American  
5 International Group, Inc. (collectively "SURETIES") will move this Court for an order permitting  
6 the SURETIES to amend the expert report previously prepared by the SURETIES' designated  
7 expert Sydney Firestone and served on defendants AAI Corporation ("AAI"), Electric Transit  
8 Incorporated ("ETI"), and Skoda (collectively "defendants").

9 This Motion requests that Ms. Firestone be allowed to amend her expert's report by  
10 providing her expert analysis and opinions on the following three issues :

11 1. Whether AAI's claim constitutes an attempt by AAI to recover its contributions of  
12 equity capital, loans or business losses (Business Loss Defense);

13 2. Whether AAI's and ETI's conduct injured or frustrated the right of AIG to receive  
14 the benefits of the indemnity agreement (Breach of Good Faith and Fair Dealing Defense);

15 3. Whether AAI's representations and assurances, including but not limited to the  
16 representations and assurances contained in status reports provided to the Sureties, are consistent  
17 with the financial and other contemporaneous reports prepared by AAI and ETI (Estoppel  
18 Defense).

19 The instant Motion is based on this Notice, the attached memorandum of Points and  
20 Authorities, the Declaration of SURETIES' attorneys David Veis and Edward Muramoto, and  
21 any and all authorities, documents, and oral argument presented in support of this Motion.

22 Dated: June 14, 2007

**ROBINS, KAPLAN, MILLER & CIRESI L.L.P.**

23 By: 

24 David C. Veis

25 Edward D. Lodgen

26 Counsel for Plaintiffs and Counterclaim-Defendants  
27 National Union Fire Insurance Company of Pittsburgh, PA.  
28 and American Home Assurance Company and Third-Party  
Defendant American International Group, Inc.

1 **I. SUMMARY OF ARGUMENT.**

2 The Ninth Circuit allows experts to amend their reports after the deadline for expert  
3 disclosure where the opposing party would not suffer “undue prejudice” as a result of the  
4 amendment. Here, the defendants will not suffer undue prejudice if the SURETIES’ expert  
5 provides the proposed amendment because the defendants have enjoyed substantial prior notice  
6 and discovery regarding the facts and issues that are the subject of the proposed amendment.

7 The deadline for serving expert reports was March 20, 2007, and on that date the  
8 SURETIES served defendants with an expert report prepared by Sydney Firestone (the “Report”).  
9 A true copy of the Report is attached as Exhibit C.

10 Ms. Firestone’s Report focused on the application of the case facts to the SURETIES’  
11 theory of relief based on the alter ego defense. *Without waiving any other defenses*, the Report  
12 prepared by Ms. Firestone sought to streamline the issues for all parties and the Court by focusing  
13 the analysis on whether AAI and ETI were alter egos. The Report was limited and focused on  
14 this issue because the SURETIES believed in good faith that the alter ego defense addressed in  
15 the Report would provide the most direct and dispositive defense. {fn <sup>1</sup>}

16 Following the parties’ exchange of expert reports, AAI filed its Motion to Strike the  
17 SURETIES’ insider defenses. The court granted AAI’s Motion on June 4, and as a result Ms.  
18 Firestone’s analysis and application of the case facts to the alter ego defense may not simplify the  
19 issues as anticipated, and may not be dispositive.

20 Due to these events, the SURETIES request that this court allow Ms. Firestone to amend  
21 her Report by applying the case facts to the following three other surety defenses:

22 1. On the Business Loss Defense - whether AAI’s claim on the surety bond  
23 constitutes an attempt to recover equity contributions, loans or business losses which AAI made

24 <sup>1/</sup> While the SURETIES requested that Ms. Firestone focus her expert Report by applying  
25 the case facts to the alter ego doctrine, that request was made not as a means of “hiding the ball”  
26 on other issues or defenses, or gaining some bad faith tactical advantage over defendants.  
27 Instead, that request was made simply as a means of streamlining the case and arguments,  
28 simplifying the issues for defendants and SURETIES and this Court, and focusing Ms.  
Firestone’s efforts on a defense (“alter ego”) which the SURETIES in good faith believed to be a  
critical and dispositive defense to AAI’s bond claim.

(Declaration of David Veis, at ¶¶ 2 - 7, filed concurrently with this Motion.)

1 to ETI which are not covered by payment bond;

2 2. On the Breach of Good Faith and Fair Dealing Defense - whether AAI's conduct  
3 injured the SURETIES' right to receive the benefits of the SURETIES' collateral and rights under  
4 the various indemnity agreements; and

5 3. On the Estoppel Defense – whether AAI's representations to the SURETIES are  
6 consistent with financial and other contemporaneous reports prepared by defendants.

7 On June 8, 2007, promptly after the court's June 4 decision striking insider-based  
8 defenses, the SURETIES wrote to counsel for defendants. The letter constituted the SURETIES'  
9 "meet and confer" and sought an agreement from defendants allowing Ms. Firestone to amend her  
10 Report. In the alternative, the SURETIES' letter requested a stipulation to shorten time for a  
11 hearing on a Motion To Allow Amendment of the Report. A copy of SURETIES' June 8, 2007,  
12 correspondence is attached hereto as Exhibit A.

13 On June 12, 2007, AAI denied the SURETIES' request to stipulate and allow Ms.  
14 Firestone to amend her Report. A true copy of AAI's June 12, 2007, letter is attached as Exh. B.

15 Contrary to the erroneous suggestion by AAI in its June 12 letter, this Motion and the  
16 identified additional defenses proposed to be addressed in the amended Report are not premised  
17 on the ETI/AAI relationship. The Business Loss Defense relates to whether or not the claim  
18 asserted by AAI relates to it providing labor and materials enhancing the project or whether its  
19 claim is based upon capital contributions, loans and business losses which are not recoverable  
20 against a payment bond.

21 Similarly, the Good Faith and Fair Dealing Defense is not based upon the relationship  
22 between AAI and ETI. Instead it is based upon AAI's failure to provide notice of ETI's non-  
23 payment under the purported AAI subcontract, which resulted in contract funds which were the  
24 collateral security of the SURETIES to be dissipated. This was to the SURETIES' detriment, and  
25 resulted in the SURETIES' indemnity rights being interfered with, lost, or impaired.

26 Finally, the Estoppel Defense is based upon AAI's representations to the SURETIES at  
27 critical times and the SURETIES detrimental reliance thereon. This defense is not premised upon  
28 the relationship between ETI and AAI. Instead it is based upon the conduct and



misrepresentations of AAI, and the reasonable reliance by the SURETIES to their detriment.

Thus, contrary to the suggestion of AAI, this Motion is not an effort to refuse to accept the Court's ruling relative to the AAI-ETI relationship. Instead, this Motion is made promptly - - a few days after the Court's striking the insider defense - - and seeks the Court's permission to amend the Report to address three defenses, none of which are based on the insider defense.

Prior to the Court's June 4 ruling, the SURETIES repeatedly emphasized in its filings and oral arguments that while the insider defense constituted one of the SURETIES' primary defenses, it was not its only defense. The SURETIES' request that Ms. Firestone focus her Report on the alter ego defense was never intended as a waiver of the SURETIES' other defenses. The SURETIES merely sought to streamline this litigation by focusing on the insider defense as it believed it to be the most direct and dispositive issue-resolving defense. Now that the Court has ruled on the inapplicability of the insider defense, the SURETIES merely seek to refocus the expert's Report on three of the SURETIES other defenses.

The defendants would not be surprised or unduly prejudiced by the proposed amendment because their prior notice of the three issues and the facts addressing these issues is evidenced by the following: (1) Ms. Firestone's current Report opines that AAI's bond claim constitutes an attempt by AAI to recover equity contributions AAI made to ETI, and discovery has revealed the defendants prior knowledge of this fact, (2) the SURETIES' defense based on the defendants' "breach of the implied covenant" is asserted in the SURETIES' Answer, and (3) the parties have aggressively investigated and litigated the SURETIES' estoppel argument as reflected by the substantial discovery on this issue and the numerous factual and legal arguments presented by the defendants in their opposition to the SURETIES' MSJ seeking judgment based on estoppel.

Moreover, the defendants have ample time to respond to the SURETIES' amended Report because expert depositions have not commenced (as of the filing of this Motion), and the SURETIES have agreed to stipulate to reasonable modifications of the expert deposition schedule to address any concerns the defendants may have regarding the SURETIES' amended Report. In sum, the defendants shall not suffer undue prejudice as a result of the proposed amendment and therefore the SURETIES respectfully request this court grant this Motion.

II. THE NINTH CIRCUIT ALLOWS LATE AMENDMENT OF EXPERT REPORTS WHERE, AS HERE, THE OPPOSING PARTY CANNOT DEMONSTRATE IT WOULD BE “UNDULY PREJUDICED” IF THE AMENDMENT IS PERMITTED.

FRCP Rule 37(c)(1) provides : “A party that without substantial justification fails to disclose information required by Rule 26(a) [expert witness disclosure] shall not, unless such failure is harmless, be permitted to use as evidence at a trial, at a hearing, or on a motion any witness or information not so disclosed.” (Emph. added.) The exclusionary penalty described in Rule 37 extends to situations where parts of an expert’s opinion are not disclosed within the deadline established for expert witness disclosure, and the opposing party seeks to exclude the late opinions based on undue prejudice, and the unavailability of lesser sanctions. (Johnson v. Sacramento County, 2007 U.S. Dist. LEXIS 6298 (E.D. Cal. 2007).)

The Ninth Circuit consistently cites five factors that a district court must weigh in analyzing exclusionary sanctions under Rule 37 :

- (1) the public's interest in expeditious resolution of litigation;
- (2) the court's need to manage its docket;
- (3) the risk of prejudice to defendants;
- (4) the public policy favoring disposition of cases on their merits; and
- (5) the availability of less drastic sanctions.

(Wendt v. Host Int’l, Inc., 125 F.3d 806, 814 (9th Cir. 1997).)

In analyzing these five factors, the Honorable D. Lowell Jensen of the Northern District of California observed that the first and second factors generally support exclusion, while the fourth weighs against exclusion, and therefore the determination of whether evidence and testimony should be excluded under Rule 37 is primarily decided based on the factors addressing the “risk of prejudice to the opposing party” and the “availability of less drastic sanctions” :

**Thus, the third and fifth factors, prejudice and availability of less drastic sanctions, are decisive.** (Atmel Corp. v. Macronix America, Inc. 2000 U.S. Dist. LEXIS 22635, p. 31 (N.D. Cal. 2000); emph. added.)



1 Similarly, in Amersham Pharmacia v. The Perkin Elmer Corp., 190 F.R.D. 644, 648-649  
 2 (N.D. Cal. 2000), Chief Magistrate Judge Edward Infante of the Northern District addressed a  
 3 defendant's violation of Rule 26's disclosure requirements arising from the late disclosure of a  
 4 publication directly relevant to the parties' patent dispute. The court allowed the late disclosure,  
 5 finding that the opposing party could not demonstrate the existence of "undue prejudice" and  
 6 therefore the public policy favoring resolution of cases on their merits prevailed over Rule 37's  
 7 exclusionary sanction :

8 Exclusion sanctions based on alleged discovery violations are generally  
 9 improper absent undue prejudice to the opposing side. (Citation omitted.)

10 The possibility that the [late disclosure of the patent publication] might influence  
 11 the outcome of the litigation in Perkin-Elmer's favor does not constitute prejudice.  
 12 See, Deakyne v. Commissioner of Lewes, 416 F.2d 290, 300 (3rd Cir. 1969)  
 13 (amendment is to be freely allowed in order to present the merits of the  
 14 controversy, if the opposing party is not actually prejudiced.) ... Nor is delay  
 15 alone a sufficient measure of prejudice. (Citation omitted.) In contrast, the  
 16 result Amersham urges may prejudice Perkin-Elmer and deprive the trier of fact  
 17 of relevant evidence if the Japanese patent publication is excluded from the  
 18 litigation. This result is wholly unwarranted in the absence of any indicia of bad  
 19 faith. See, Freeman v. Package Machinery Co., 865 F.2d 1331, 1341 (1st Cir.  
 20 1988) (holding that lower court is well within its discretionary authority in  
 21 declining to impose the extreme preclusion sanction, in the absence of  
 22 willfulness, bad faith or significant prejudice)... Preclusion of evidence or  
 23 testimony is a grave step, and is by no means an automatic response to a delayed  
 24 disclosure. (Amersham Pharmacia v. The Perkin Elmer Corp., 190 F.R.D. 644,  
 25 648-649 (N.D. Cal. 2000); 2000 U.S. Dist LEXIS 1142, at 15-16; *emph. added.*)  
 26

27 In the instant action, the defendants would suffer no unfair surprise or undue prejudice as  
 28 a result of the SURETIES' proposed amendment because the defendants have not only been fully

1 aware of the three defenses which the SURETIES seek to address in the amended Report, but the  
2 defendants have also been aware of the *facts* supporting these three defenses. In the amended  
3 Report proposed by the SURETIES, Ms. Firestone's analysis of the facts of this case would  
4 remain the same, or substantially the same ; the facts analyzed in her original Report and any  
5 additional facts and opinions would merely be applied in the context of the three defenses, all of  
6 which have been investigated and aggressively litigated by the defendants from the inception of  
7 this suit, or at least throughout discovery.

8 In light of the Court's recent June 4 order striking the SURETIES' insider defense, it is  
9 critically important that the SURETIES and Ms. Firestone be allowed to amend the Report to  
10 ensure this suit is decided on the merits. (Wendt v. Host Int'l, Inc., 125 F.3d 806, 814 (9th Cir.  
11 1997) [public policy favoring disposition of cases on their merits is one of the five factors that  
12 must be weighed in analyzing whether exclusion is appropriate].) As demonstrated below, the  
13 defendants shall not suffer undue prejudice as a result of the proposed amendment, and therefore  
14 the SURETIES respectfully request the court grant this Motion.

15  
16 **III. FIRESTONE'S REPORT OBSERVES THAT AAI'S BOND CLAIM IS AN**  
17 **ATTEMPT TO RECOVER EQUITY CONTRIBUTIONS AAI MADE TO ETI,**  
18 **AND DISCOVERY REVEALED THE DEFENDANTS' RECOGNITION OF THIS**  
19 **FACT; THESE FACTS PRECLUDE ANY CLAIM OF "UNDUE PREJUDICE."**

20 With respect to the first proposed amendment, the SURETIES contend that AAI's claim  
21 constitutes an attempt by AAI to recover its contributions of equity capital provided to ETI. The  
22 SURETIES contend that such claims are not covered by payment bonds. The defendants cannot  
23 claim that they were unaware of the facts and circumstances the SURETIES rely upon in support  
24 of this defense because Ms. Firestone's current Report concludes that AAI provided funding and  
25 equity capital necessary for ETI to stay afloat and these amounts became the basis for its present  
26 claim. (See, Report, at ¶¶ 15, 19-26; attached as Exhibit C.)

27 Importantly, the SURETIES' document production requests and AAI's and ETI's  
28 production of documents focused on whether AAI's bond claim constituted an attempt to obtain

1 compensation for the equity contributions AAI made to ETI. Additionally, depositions taken last  
2 year also addressed this defense. (See, excerpts of SURETIES' document demands, attached as  
3 Exhibit D; see also, excerpts of depositions of AAI's James Perry, and ETI's Philip Gansert,  
4 attached as Exhibits E and F, respectively.)

5 Moreover, in the SURETIES' Opposition to AAI's Motion to Strike, the SURETIES  
6 specifically argued that "The claim asserted by AAI is not one for labor and materials supplied to  
7 the project, but is to recover AAI's funding of ETI's working capital shortages, loans and  
8 financing – these being business losses not recoverable upon the payment bond." (See,  
9 SURETIES' Opposition to Motion to Strike, filed April 27, 07, at page 1, lines 14-19; excerpt  
10 attached as Exhibit G.) In sum, the defendants have been acutely aware of this defense as well as  
11 the facts supporting this defense for at least several months, and therefore they would suffer no  
12 surprise or undue prejudice if Ms. Firestone's Report was amended to fully address and apply the  
13 case facts to the SURETIES' defense that the payment bond does not cover AAI's attempt to  
14 recover its equity contributions made to ETI.

15  
16 **IV. THE SURETIES' ANSWER ALLEGES THE DEFENDANTS BREACHED THE**  
17 **IMPLIED COVENANT OF GOOD FAITH, AND FIRESTONE'S REPORT CITES**  
18 **FACTS SUPPORTING THIS CLAIM. CONSEQUENTLY, THERE WOULD BE**  
19 **NO 'UNDUE PREJUDICE' IF THE REPORT FULLY ADDRESSED THIS ISSUE.**

20 With respect to the second defense, the SURETIES contend that the defendants' conduct  
21 injured and frustrated the SURETIES' right to receive the benefits of the indemnity agreements  
22 and constitute a breach of the implied covenant of good faith and fair dealing, thereby  
23 exonerating the bond. The defendants cannot claim surprise because this affirmative defense is  
24 specifically plead in the SURETIES' Answer, filed on May 3, 2005. (See, SURETIES' Answer  
25 at 26th Affirmative Defense.)

26 Importantly, Ms. Firestone's Report as currently written provides additional notice to the  
27 defendants on this issue because it observes that AAI's and ETI's selective payments to third  
28 parties - - while failing to pay AAI - - frustrated the SURETIES' rights and constituted

unreasonable conduct, culminating in AAI's present claim:

"AAI's loans or advances to ETI were used to pay for purchases from subcontractors .... AAI also financed ETI by continuing to provide subcontracting services without receiving payment for all of its prior subcontracting services. AAI did not, however, choose to advance funds to ETI to pay for AAI's subcontracting services and, when ETI received payments from MUNI, both ETI and AAI chose to apply those payments to payables to third parties and to AAI's advances and unpaid seconded services, rather than to AAI's unpaid subcontracting services." (See, Report, ¶ 15; attached as Exh. C.)

Based on the foregoing, the defendants have been on notice since the filing of the SURETIES' Answer that the SURETIES contend the defendants breached the implied covenant of good faith and fair dealing, thereby exonerating the bond. In light of the current Report's reference to facts supporting this defense, the defendants cannot claim they were unaware of this defense or the facts supporting this defense. Accordingly, the defendants would not suffer any "undue prejudice" if the Report were amended to fully address the case facts as they apply to the SURETIES' defense based on the defendants' alleged breach of the implied covenant of good faith and fair dealing.

**V. THE DEFENDANTS HAVE AGGRESSIVELY OPPOSED THE SURETIES' ESTOPPEL DEFENSE, AND THE SURETIES' NOV. 2006 MSJ ON THIS ISSUE CITED FACTS SUPPORTING THIS DEFENSE; ACCORDINGLY, THE DEFENDANTS CANNOT CLAIM SURPRISE OR "UNDUE PREJUDICE."**

On the third defense for which the SURETIES seek Ms. Firestone's amended opinion, the SURETIES contend that the defendants' conduct and their assurances contained in status reports provided to the SURETIES were reasonably and detrimentally relied upon by the SURETIES, and operate to estop AAI from prevailing on its bond claim. As part of the estoppel defense, the SURETIES contend that the defendants misrepresented the true state of facts regarding the status

1 of the MUNI Project and lulled the SURETIES into a false sense of security, preventing the  
2 SURETIES from taking steps to protect themselves against the potential liability represented by  
3 AAI's present bond claim. (See, SURETIES' Motion for Summary Judgment filed November  
4 13, 2006, at pages 19-21; excerpt attached as Exhibit H.)

5 Ms. Firestone's amended Report would address whether AAI's representations and  
6 assurances, including but not limited to the representations and assurances contained in status  
7 reports provided to the Sureties, are consistent with financial and other contemporaneous reports  
8 which were prepared by AAI and ETI and used by the defendants internally or which were  
9 otherwise not provided to the SURETIES. In her capacity as a forensic accountant, Ms. Firestone  
10 shall also opine on whether the defendants' representations and assurances as made to the  
11 SURETIES, when compared to other financial data prepared by the defendants, comply with  
12 generally accepted accounting principles, and other standards for reporting financial information.

13 The defendants cannot claim surprise or undue prejudice because they have been aware of  
14 the SURETIES' estoppel defense - - and the facts supporting this defense - - for at least the past  
15 several months. This specific defense and the facts supporting the defense were presented and  
16 fully briefed in the SURETIES' Motion for Summary Judgment (filed November 13, 2006, at  
17 pages 19-21; excerpt attached as Exhibit H), and AAI responded to this defense and supporting  
18 facts in its Opposition to MSJ (filed December 29, 2006, at pages 19-21; excerpt attached as  
19 Exhibit I).

20 Additionally, Ms. Firestone's current Report provides the defendants with additional  
21 analysis of facts applicable to the SURETIES' estoppel defense as she observes : "AAI further  
22 acknowledged its financial commitment to ETI in a series of reports to AIG...." (See, Report, ¶  
23 25; attached as Exh. C.)

24 Moreover, in AAI's Reply Brief submitted in support of its recent Motion to Strike, AAI  
25 acknowledged the SURETIES' claim for relief based on estoppel and assured this court that  
26 **"AAI's Motion to Strike Does Not Seek to Preclude AIG's Estoppel Argument."** (See,  
27 AAI's Reply Brief supporting its Motion to Strike, filed May 4, 2007, at p. 11, lines 5-6, and 21-  
28 22; emph. added; excerpt attached as Exh. J.) Accordingly, the defendants have enjoyed ample



notice of the estoppel defense as well as the facts supporting this defense, and therefore they cannot demonstrate unfair surprise or undue prejudice if Ms. Firestone amended her Report to fully apply the case facts to this defense.

**VI. THE AMENDMENT SHOULD BE ALLOWED BECAUSE EXPERT DEPOSITIONS HAVE NOT COMMENCED, THE SURETIES WILL STIPULATE TO REASONABLE DISCOVERY MODIFICATIONS, AND THE SURETIES PROMPTLY SOUGHT RELIEF FOLLOWING THE JUNE 4 ORDER.**

Importantly, exclusion of the proposed amendment is particularly inappropriate here, not only because of the absence of undue prejudice, but also because lesser and more appropriate sanctions - - such as discovery modifications - - are available to mitigate any *potential* prejudice. (*Johnson v. Sacramento County*, 2007 U.S. Dist. LEXIS 6298 [court declined to strike tardy expert's testimony because it would "gut plaintiff's case" (Id. at p. 4), the opposing party was not "substantially prejudiced" (Id. at p. 5), and lesser sanctions, such as discovery modifications, were available to address any unfairness (Id. at 11.)]; see also, *Atmel Corp.*, 2000 U.S. Dist. LEXIS 22635, p. 32 [exclusion of evidence and testimony under Rule 37 turns on the "risk of prejudice to the opposing party" and the "availability of less drastic sanctions"].)

Expert depositions have not yet commenced (as of the filing of this Motion) and the SURETIES have offered to stipulate to reasonable modifications of the expert witness deposition schedule and rebuttal expert disclosure deadline as a means of addressing any legitimate concerns the defendants may have with respect to the SURETIES' proposed amendment. Consequently, the defendants shall have ample opportunity to prepare for and depose Ms. Firestone regarding her amended Report, and if the defendants believe that rebuttal experts are appropriate based on the amended Report, lesser sanctions in the form of the SURETIES' stipulation to reasonable discovery modifications - - including late disclosure of rebuttal experts - - ameliorates any *potential* prejudice.

The SURETIES promptly sought the relief requested in this Motion following the Court's June 4 Order striking the insider defense. Following the Court's June 4 Order, the SURETIES

1 wrote the defendants on June 8 seeking a stipulation allowing the proposed amendments to Ms.  
2 Firestone's Report. (Exh. A.) In a letter dated June 12, AAI's counsel refused to stipulate to  
3 allowing the amendment. (Exh. B.) On June 14, the SURETIES filed this Motion.

4  
5 Based on the foregoing, the SURETIES respectfully request that the Court grant the  
6 SURETIES' Motion to Allow Amendment of Expert's Report.

7  
8 Dated: June 14, 2007

**ROBINS, KAPLAN, MILLER & CIRESI L.L.P.**

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16 Pennsylvania and American Home Assurance Company  
17 and Third-Party Defendant American International Group,  
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# EXHIBIT A

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Re: National Union Fire Ins. Co., et al v. Electric Transit Inc., AAI Corp., et al.  
US District Court, Northern District of California, Case No. C 04 3435

Dear Counsel:

This letter constitutes AIG's "meet and confer" and requests the parties' stipulation permitting AIG to supplement the opinions contained in Sydney Firestone's expert report dated May 20, 2007 (the "Report"). AIG requests the parties allow Ms. Firestone to amend and supplement her Report by providing her expert opinion on the following three issues :

1. Whether AAI's claim constitutes an attempt by AAI to recover its contributions of equity capital to ETI ;
2. Whether AAI's and ETI's conduct injured or frustrated the right of AIG to receive the benefits of the indemnity agreement ;
3. Whether AAI's representations and assurances, including but not limited to the representations and assurances contained in the status reports, are consistent with the financial and other contemporaneous reports prepared by AAI and ETI.

While Ms. Firestone's Report comprehensively addressed the facts dealing with these issues (AAI's equity contributions made to ETI, AAI's conduct which frustrated AIG's rights under the indemnity agreement, and AAI's representations and assurances), these facts were analyzed in the context of whether AAI and ETI were alter egos. The Report focused on the

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application of these facts to the alter ego doctrine because, at the time Ms. Firestone was retained and the Report was prepared, AIG sought to streamline, *but did not waive*, the numerous factual and legal issues in this case by focusing the Report on the alter ego doctrine. In light of the Court's June 4 order striking AIG's alter ego claim as it relates to whether AAI was a proper claimant under the insider defense, AIG seeks to amend and supplement the Report to fully and completely address facts as they relate to the three issues cited above.

The parties would suffer no prejudice as a result of AIG's request because in the proposed amended and supplemental Report, Ms. Firestone's reference to the foregoing facts would remain substantially the same; these facts and any additional facts and opinions would merely be analyzed in the context of the three issues identified above. Moreover, any *potential* for prejudice is eliminated by the fact that expert witness depositions have not commenced, and rebuttal experts have not yet been disclosed, thereby providing the defendants with an opportunity to address, rebut, or otherwise respond to the amended and supplemental Report.

The parties cannot claim unfair surprise because, as demonstrated below, they have been aware of these three issues from the inception of this suit, or at least throughout discovery.

With respect to the first issue, AIG contends that AAI's claim constitutes an attempt by AAI to recover its contributions of equity capital provided to ETI. Such claims are not covered by payment bonds. The defendants cannot claim surprise on this issue as the current Report concludes that AAI provided funding and equity capital necessary for ETI to stay afloat and these amounts became the basis for its present claim. (See, Report, at ¶¶ 15, 19-26.) Importantly, AIG's document production requests and AAI's and ETI's production of documents focused on this issue, and several depositions taken last year dealt with this defense.

Additionally, in AIG's Opposition to AAI's Motion to Strike, AIG specifically argued that "The claim asserted by AAI is not one for labor and materials supplied to the project, but is to recover AAI's funding of ETI's working capital shortages, loans and financing - these being business losses not recoverable upon the payment bond." (AIG's Opposition to Motion to Strike, filed April 27, 07, at page 1, lines 14-19.) In sum, the defendants have been acutely aware of this issue and they would suffer no surprise or undue prejudice by allowing the proposed amended and supplemental Report.

With respect to the second issue, AIG contends that the defendants' conduct injured and frustrated AIG's right to receive the benefits of its indemnity agreement and constituted a breach of the implied covenant of good faith and fair dealing, thereby exonerating the bond. The defendants cannot claim surprise as this affirmative defense is specifically pleaded in AIG's Answer filed on May 3, 2005. (See, AIG's Answer at 26th Affirmative Defense.) Additionally, the current Report provides further notice to the defendants on this issue because it reflects that AAI's and ETI's selective payments to third parties - - while failing to pay AAI - - frustrated AIG's rights and constituted unreasonable conduct, culminating in AAI's present claim:

"AAI's loans or advances to ETI were used to pay for purchases from subcontractors .... AAI also financed ETI by continuing to provide subcontracting services without receiving payment for all of its prior



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subcontracting services. AAI did not, however, choose to advance funds to ETI to pay for AAI's subcontracting services and, when ETI received payments from MUNI, both ETI and AAI chose to apply those payments to payables to third parties and to AAI's advances and unpaid seconded services, rather than to AAI's unpaid subcontracting services." (Report, ¶ 15.)

Finally, on the third issue, AIG contends that the assurances contained in the status reports were reasonably and detrimentally relied upon by AIG, and operate to estop AAI from prevailing on its claim. The defendants have been aware of AIG's estoppel defense for at least the past several months because this specific argument was presented and fully briefed in AIG's Motion for Summary Judgment (at pages 19-21, filed November 13, 2006), and also addressed in AAI's Opposition to MSJ (at pages 19-21, filed December 29, 2006). The Report provides the defendants with additional notice on this issue as it observes "AAI further acknowledged its financial commitment to ETI in a series of reports to AIG...." (Report, ¶ 25.)

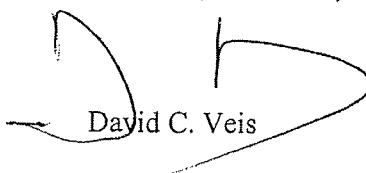
Moreover, in AAI's Reply Brief submitted in support of its recent Motion to Strike, AAI acknowledges the sureties' claim for relief based on estoppel and assures this court that **"AAI's Motion to Strike Does Not Seek to Preclude AIG's Estoppel Argument."** (AAI's Reply Brief supporting its Motion to Strike, filed May 4, 2007, at p. 11, lines 5-6, and 21-22; emph added.) Accordingly, the defendants cannot claim surprise regarding AIG's defense of estoppel.

As demonstrated above, the proposed amended and supplemental Report requested by AIG addresses facts, defenses, and three specific issues which the defendants have been fully aware of since the inception of this suit, or have aggressively litigated for at least several months. Because expert depositions have not commenced, and rebuttal experts have not yet been disclosed, no surprise or undue prejudice would be suffered by the defendants by allowing Ms. Firestone to amend and supplement her Report by applying and expanding her existing analysis to address these three issues.

While AIG believes it may be entitled to unilaterally amend and supplement the Report without the parties' approval, AIG presents this request to prevent any misunderstanding, or objections at trial. In light of this request, AIG offers to stipulate to, and request the court's approval for, any reasonable modification or extension of expert deposition schedules and deadlines, rebuttal expert disclosure deadlines, and exchange of supplemental reports proposed by the other parties.

Please let us hear from you regarding this request by Tuesday June 12, 2007. If you will not stipulate to allow AIG to amend and supplement the Report, we ask that you agree to a Motion to Shorten Time.

Very truly yours,  
ROBINS, KAPLAN, MILLER & CIRESI L.L.P.



David C. Veis

# EXHIBIT B

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June 12, 2007

Via Electronic and Regular Mail

David C. Veis, Esq.  
Robins, Kaplan, Miller & Ciresi LLP  
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Re: AIG v. Electric Transit Incorporated, et al.  
Civil Action C 04-3435 JSW

Dear David:

This responds to your June 8, 2007 letter, which you characterize as a "meet and confer" on AIG's request that AAI "stipulat[e] and permit[] AIG to supplement the opinions contained in Sydney Firestone's expert report dated May 20, 2007" (the "Firestone Report"). For the reasons discussed below, AAI will not agree to AIG's request.

First, none of the "issues" that the proposed supplemental Firestone Report seeks to address support legally cognizable defenses. Rather, the "new" issues merely recapitulate aspects of the relationship-based "insider" defenses that the Court has now rejected in two separate orders. You are once again refusing to accept that the Court has ruled, twice, that defenses based on the alleged AAI-ETI relationship have no bearing on any issue in this case.

Second, AIG's suggestion that "it may be entitled to unilaterally amend and supplement the Report without the parties' approval . . ." is completely baseless. You cite no authority for the outlandish proposition that AIG may unilaterally amend or supplement the Firestone Report. Pursuant to Federal Rule of Civil Procedure 26(a)(2)(C), AIG and AAI were required to provide their expert disclosures by March 20, 2007. *Id.* By that date, AIG was required to provide an expert report that included, among other things, "a complete statement of all opinions to be expressed and the basis and reasons therefor, the data or other information considered by the witness in forming the opinions; [and] any exhibits to be used as a summary of or support for the opinions." *F.R.C.P. 26(a)(2)(B)* (emphasis added). The Firestone Report that AIG submitted to AAI on March 20, 2007 relates solely to "identifying and evaluating indicia of ETI being the alter ego of AAI as it relates to the claims asserted by AAI," (Firestone Report at ¶ 4), and makes no mention of any other issues as to which Ms. Firestone would offer an opinion at trial.

KASOWITZ, BENSON, TORRES & FRIEDMAN LLP

Third, you are wrong in suggesting that AAI is somehow not prejudiced by AIG's eleventh-hour request to supplement the Firestone Report. AIG has forced AAI to waste time and resources litigating the inapplicability of AIG's relationship-based "insider" defenses for the third time. Moreover, an amended Firestone Report would cause inevitable delay, as AAI, upon receiving it (tellingly, you have not advised us when AIG would even be serving any such amended report), would need to obtain and prepare a rebuttal expert. The bottom line is AIG made a tactical decision, initially, to have its expert opine solely on alter ego issues, and to then refrain from seeking to supplement that opinion until after the Court had issued its Order striking the sole defense (alter ego) the Firestone Report was offered to support. The deadlines imposed by the Federal Rules and the Court's Scheduling Order do not permit AIG to amend its expert reports because its litigation strategy was predicated on legally invalid defenses.

Finally, concerning your request that AAI "stipulate to an order shortening the time for the hearing" on AIG's proposed motion to supplement the Firestone Report, AAI is willing to consider such a stipulation on the condition that AIG agrees that the date for the hearing on such a motion is the same as the date for the hearing on AIG's recently filed motion to amend its answer.

Sincerely,



Ronald R. Rossi

cc: Theodore J. Low, Esq. (via electronic mail)  
Jonathan A. Ross, Esq. (via electronic mail)  
David Alexander, Esq. (via electronic mail)